

## Internal Revenue Service

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Washington, DC 20224

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B01

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Date: March 30, 2009

X =

A =

B =

C =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Trust 5 =

Trust 6 =

Trust 7 =

Trust 8 =

Trust 9 =

Trust 10 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

p =

q =

r =

s =

Year 1 =

Year 2 =

Year 3 =

Dear :

This responds to a letter dated December 3, 2008, and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

## FACTS

X was incorporated on Date 1, and made an election to be treated as an S corporation effective Date 2. A was the sole shareholder of X on Date 2. On Date 3, A transferred X stock to Trust 1. X represents that Trust 1 was a grantor trust, the assets of which were treated for federal income tax purposes as solely owned by A. On Date 4, B transferred p shares of X to each of Trust 4, Trust 5, and Trust 6. On Date 7, B transferred q shares of X to each of Trust 4, Trust 5, and Trust 6. On Date 5, C transferred r share of X to each of Trust 7, Trust 8, and Trust 9. On Date 6, C transferred r share of X to Trust 10. On Date 7, Trust 1 terminated, and Trust 1 transferred s shares of X to each of Trust 2 and Trust 3.

Trust 2, Trust 3, Trust 4, Trust 5, Trust 6, Trust 7, Trust 8, Trust 9, and Trust 10 are collectively referred to as the Trusts. X represents that X and the grantors, trustees, and beneficiaries of the Trusts intended that each of the Trusts be treated as a qualified subchapter S trust (QSST). The instruments for each of the Trusts include the terms required of a QSST described in § 1361(d)(3)(A). Though the instruments for each of the Trusts do not require the trustees of the Trusts to distribute all of the Trusts' income (within the meaning of § 643(b)) to each Trust's current income beneficiary, X represents that X and the grantors, trustees, and beneficiaries of the Trusts intended that all such income would actually be distributed.

Due to an oversight, the beneficiaries of the Trusts failed to make QSST elections for the Trusts. As a result, X's S corporation election terminated on Date 4 when Trust 4, Trust 5, and Trust 6 became shareholders.

Nevertheless, X has represented that X has been treated as an S corporation since Date 2. Furthermore, for Year 1 and all subsequent taxable years, X has represented that the Trusts were treated by their beneficiaries as QSSTs effective as of the Trusts' respective dates of formation. Furthermore, X represents that each of the Trusts' beneficiaries reported all of their respective shares of X's income on their individual income tax returns for Year 1 and all subsequent taxable years.

Though Trust 2 and Trust 3 did distribute all of their income (within the meaning of § 643(b)), Trust 4, Trust 5, Trust 6, Trust 7, Trust 8, Trust 9, and Trust 10 each failed to distribute to their respective beneficiaries an immaterial amount of income.

X's S corporation election would also have terminated (if it had not already terminated on Date 4) on Date 5, Date 6, and Date 7 due to the additional transfers of X stock. Furthermore, X's S corporation election would have terminated (if it had not

already terminated on Date 4) on the first day of Year 2 and of each subsequent year through Year 3 due to the failure of certain of the Trusts to distribute all of their income to their respective beneficiaries.

X represents that the failure to file QSST elections for the Trusts, and the failure to distribute all of the income, were not motivated by tax avoidance or retroactive tax planning. X and its shareholders have agreed to make any adjustments that the Commissioner may require, consistent with the treatment of X as an S corporation.

### LAW AND ANALYSIS

Section 1362(a) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1361(a)(1) provides that the term “S corporation” means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that, for purposes of subchapter S, the term “small business corporation” means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(c)(2)(A)(i) provides that, for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States may be an S corporation shareholder.

Section 1361(d)(1) provides that, in the case of a qualified subchapter S trust with respect to which a beneficiary makes an election under § 1361(d)(2), (A) such trust will be treated as a trust described in § 1361(c)(2)(A)(i), and (B) for purposes of § 678(a) the beneficiary of such trust shall be treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under § 1361(d)(2) is made.

Section 1.1361-1(j)(7)(i) of the Income Tax Regulations provides that the income beneficiary who makes the QSST election and is treated (for purposes of § 678(a)) as the owner of that portion of the trust that consists of S corporation stock is treated as the shareholder for purposes of §§ 1361(b)(1), 1366, 1367, and 1368.

Section 1361(d)(3)(A) provides that for purposes of § 1361(d), the term “qualified subchapter S trust” means a trust the terms of which require that (i) during the life of the

current income beneficiary, there shall be only 1 income beneficiary of the trust, (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary, (iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of such beneficiary's death or the termination of the trust, and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to such beneficiary.

Section 1361(d)(3)(B) provides that for purposes of § 1361(d), the term "qualified subchapter S trust" means a trust all of the income (within the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to 1 individual who is a citizen or resident of the United States.

Section 1361(d)(4) provides that if any QSST ceases to meet any requirement of § 1361(d)(3)(B) but continues to meet the requirements of § 1361(d)(3)(A) (regarding the terms of the trust), the provisions of § 1361(d) shall not apply to such trust as of the first day of the first taxable year beginning after the first taxable year for which it failed to meet the requirements of § 1361(d)(3)(B).

Section 1.1361-1(j)(6)(ii) provides that the current income beneficiary of a QSST must make the election under § 1361(d)(2) by signing and filing with the service center with which the corporation files its income tax returns the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1362(d)(2) provides that (A) in general, an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation and (B) any termination under § 1362(d)(2) shall be effective on and after the date of cessation.

Section 1.1361-1(j)(6)(iii)(E) provides that, if a corporation's S election terminates because of a late QSST election, the corporation may request inadvertent termination relief under § 1362(f).

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents or (B) was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in the ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation or (B) to acquire the shareholder consents, and (4) the corporation and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the

corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in the ineffectiveness or termination, the corporation will be treated as an S corporation during the period specified by the Secretary.

## CONCLUSIONS

Based solely on the facts submitted and the representations made, we conclude that the termination of X's S corporation election on Date 4 was inadvertent within the meaning of § 1362(f). We further hold that, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date 4 and thereafter, provided X's S corporation election was valid and provided that the election was not terminated under § 1361(d) as a result of an event or a transaction other than those described in this ruling. The Trusts will be treated as QSSTs from Date 4 and thereafter. This ruling is conditioned upon the beneficiaries of the Trusts filing appropriately completed QSST elections for the Trusts effective as of the date that each of the respective Trusts first acquired X stock. The QSST elections must be filed within 60 days following the date of this letter and a copy of this letter should be attached to any such elections or returns.

The shareholders of X must include their pro-rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X or its shareholders fail to treat themselves as described above, this ruling is null and void.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provisions of the Code. In particular, we express no opinion on whether X is otherwise eligible to be an S corporation, or on whether the Trusts are otherwise eligible to be QSSTs.

This ruling is directed only to the taxpayer that requested it. Section 6110(j)(3) provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file, a copy of this letter is being sent to X's authorized representative.

Sincerely,

*Dianna K. Miosi*

Dianna K. Miosi  
Chief, Branch 1  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

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